(2)

No. 01-147

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 2001

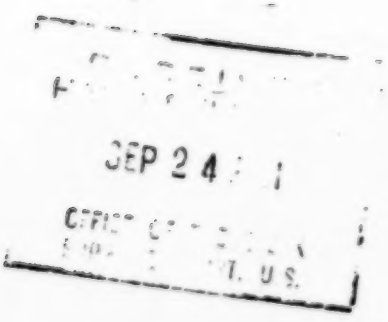
SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

CHARLES ZANDFORD,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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QUESTIONS PRESENTED

1. Whether the petition for certiorari properly asks this Court to consider the adequacy of the SEC's civil complaint to state a cause of action for securities fraud when that issue was neither raised below by the SEC nor considered by the court of appeals.

2. Whether the court of appeals correctly concluded that proof that a stock broker converted funds from a discretionary securities investment account does not, without more, establish fraud "in connection with" a sale of securities within the meaning of Section 10(b) of the Securities Act of 1934 or Rule 10b-5 of the Securities and Exchange Commission.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

STATEMENT

Because respondent Charles Zandford questions whether the petition for certiorari presents an issue that was preserved for review, this statement will describe with some specificity what the Securities and Exchange Commission ("SEC") pressed and what the court of appeals passed upon below. The SEC sought summary judgment in this civil securities fraud action it brought against Charles Zandford. It contended below that under the doctrine of collateral estoppel, Zandford's prior criminal conviction for wire fraud precluded any defense to the civil

action it had brought against him. Pet. App. 3a, 16a-17a.[1] The district court agreed and granted summary judgment in favor of the SEC. Pet. App. 17a-18a. The court of appeals concluded, however, that the facts established from the criminal case did not establish securities fraud. On that basis, it reversed the district court and also directed that the case be dismissed. Pet. App. 4a-5a, 14a. The SEC does not ask this Court to review the summary judgment ruling. Rather, the SEC now asks this Court to grant review and to decide for the first time in this case whether the facts asserted in the civil complaint, including significant assertions, which were neither established for purposes of summary judgment nor considered by the court of appeals, establish securities fraud.

The Wire Fraud Conviction

In April of 1995, a federal grand jury returned a superseding indictment, charging Zandford with thirteen counts of wire fraud. Pet. App. 40a. The superseding indictment alleged that Zandford, a securities broker and representative, had engaged in a scheme to defraud William Wood ("Wood"), and his daughter Diane Wood Okstulski ("Okstulski") (collectively "the Woods"), two customers who had opened an investment account through Zandford in November of 1987 at the Maryland offices of Dominick & Dominick ("Dominick"), "a securities broker/dealer." Pet. App. 40a-41a ¶¶ 1-3.

In outlining the scheme to defraud, the superseding indictment alleged that between November of 1987 and March of 1988, the Woods entrusted Zandford with a total of $419,225 to

[1] "Pet. App." refers to the appendix filed with the petition for certiorari. "Opp. App." refers to the appendix filed with the brief in opposition.

be held in their investment account, and that Zandford depleted the money by September 28, 1990. Pet. App. 41a at ¶ 4. The indictment specifically alleged that between March of 1988 and September of 1990, Zandford caused checks in the amount of $346,292.78 to be issued from the investment account. Pet. App. 41a-42a at ¶ 5. These checks were allegedly issued "against the security positions" of the Woods, causing their securities to be "liquidated." Pet. App. 41a at ¶ 5. According to the superseding indictment, Zandford then made personal use of that money. Pet. App. 41a-42a at ¶ 5. Additionally, the superseding indictment alleged that Zandford "sold securities in William R. Wood and Diane Wood Okstulski's joint investment account, deposited a check made payable to William Wood from the Department of Labor, Office of Workmen's Compensation into the joint investment account and then made personal use of the money." Pet. App. 42a at ¶ 6.

Each of the thirteen counts of the superseding indictment charged Zandford with causing a wire transfer to be made between Maryland and New York in execution of the scheme to defraud. Count One alleged that a wire transfer communication was made "in connection with the purchase of mutual fund shares" on behalf of the Woods in March of 1988.[2] Pet. App. 42a at ¶ 7. Counts Two through Thirteen charged Zandford with causing wire communications to be made "in connection with" the withdrawal of funds from the Woods' investment account over a two-year period, from August of 1988 to September of 1990. Pet. App. 40a-50a.

Zandford was convicted on all counts, sentenced to 52 months in prison, and ordered to pay $10,800 in restitution. Pet. App. 2a. On appeal, he argued, inter alia, that there was

[2] The court of appeals mistakenly referred to this count as involving a sale of shares in a mutual fund. Pet. App. 2a, 35a.

insufficient evidence of a scheme to defraud because the Woods had willfully transferred their money to him via three lawfully-executed agreements. Pet. App. 35a. The court of appeals rejected Zandford's argument without making any reference to securities. In determining that there was insufficient evidence to sustain the conviction, the court of appeals pointed to various factors in determining that there was sufficient evidence to sustain the conviction, including the Woods' mental and physical limitations, the transfer of large sums of money from the investment account to Zandford's own accounts, and the fact that the agreements underlying Zandford's defense were contrary to the Woods' conservative investment objectives. Pet. App. 36a-38a.

The SEC's Civil Complaint

In September of 1995, the SEC filed the civil complaint in this action, under Section 17(a) of the Securities Act of 1933, 17 U.S.C. § 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5. Pet. App. 25a. The complaint alleged that Zandford "misappropriated" $343,000 of the Woods' funds and that he excessively traded securities from their investment account. Pet. App. 27a at ¶ 10. According to the complaint, Wood, who suffered from various physical and mental disabilities, opened the investment account on behalf of himself and his mentally disabled daughter Okstulski, with "safety of principle and income" as his objective. Pet. App. 27a-28a at ¶¶ 9, 11, 13. The complaint alleged that Wood made an initial deposit of $130,000 in September of 1987 and gave Zandford an additional $289,000 in March of 1988. Pet. App. 27a-28a at ¶¶ 11, 12. Additionally, the complaint alleged that Wood held unspecified mutual fund shares outside the investment account. Pet. App. 27a at ¶ 10.

As to the misappropriation claim, the complaint alleged that Zandford's fraudulent scheme began in May of 1988, shortly after Wood was hospitalized with a stroke. Pet. App. 28a at ¶ 16. Between May and June of 1988, Zandford issued three checks to himself totaling $41,000 that were allegedly drawn on the Woods' mutual fund account, after mutual fund shares in the account were sold. Pet. App. 28a at ¶ 16. Zandford obtained an additional $145,000 in July of 1998 by selling securities in the investment account and then obtaining a check from Dominick that he deposited into a bank account under his control. Pet. App. 29a at ¶ 17. The complaint further alleged that between July of 1988 and June of 1990, Zandford sold securities held in the investment account as well as mutual fund shares held elsewhere. Pet. App. 29a at ¶ 18. After the resulting proceeds were deposited into the Woods' investment account, Zandford caused checks totaling $157,000 to be issued from that account and deposited them into his own accounts. Pet. App. 29a at ¶ 18. Finally, the complaint alleged that Zandford engaged in excessive trading, or "churning." Pet. App. 30a at ¶¶ 20-23.

The SEC's Motion for Partial Summary Judgment

In April of 1998, the SEC moved for partial summary judgment based exclusively on a collateral estoppel theory. Pet. App. 3a, 16a-17a. It asserted that the facts established in the superseding indictment also established civil securities fraud and that Zandford was estopped from contesting those facts. Opp. App. 15a-16a. The SEC supported the motion with selected portions of the record from the criminal case, including in pertinent part: the superseding indictment, jury charge, verdict form, criminal judgment, and the unpublished opinion of the court of appeals affirming the conviction. Opp. App. 16a-17a.

Zandford moved to conduct limited discovery. Pet. App. 3a. The SEC opposed Zandford's discovery request, claiming that such discovery was irrelevant to answer the motion for partial summary judgment because "[t]he Commission's motion for partial summary judgement [sic] is based exclusively on the application of the doctrine of collateral estoppel." Opp. App. 11a (emphasis added).

The District Court Decision and the Appeal

On March 2, 1999, the district court granted the SEC's motion for partial summary judgment, enjoined Zandford from committing future violations of the securities laws, and awarded disgorgement in the amount of $343,000, without prejudgment interest, less a credit of $10,800 for the prior restitution award.[3] Pet. App. 17a-18a, 21a-24a. The district court found that "Zandford's criminal conviction was based on the same facts alleged by the Commission against Zandford . . . and that Zandford is therefore collaterally estopped from relitigating the facts underlying his conviction." Pet. App. 22a. The district court granted summary judgment because it found that the prior criminal conviction established all elements of the SEC's misappropriation claim. Pet. App. 16a-17a, 22a. Zandford appealed.

[3] The SEC had reserved from the motion for partial summary judgment the claims of excessive trading, or "churning," which it acknowledged were not addressed by the criminal conviction and thus could not be resolved by invoking collateral estoppel. Opp. App. 16a, n.1. The SEC later made clear to the court of appeals that because it was "unlikely to receive any further relief by pursuing its excessive trading claims, the Commission has no intention of taking any further action against Zandford. Consequently, the Commission did not question the district court's decision to enter final judgment even though the Commission moved for partial summary judgment." Opp. App. 9a n.2.

In an opinion written by Chief Judge Wilkinson, and joined by Judges Michael and Traxler, the court of appeals reversed the district court, determining that Zandford was not estopped from defending the motion for summary judgment. Pet. App. 1a. The court of appeals applied this Court's decision in Emich Motors Corp. v. General Motors Corp., 340 U.S. 558 (1951), which holds that collateral estoppel operates to foreclose the relitigation of any legal issues or facts in a subsequent civil proceeding that were previously "put in issue and directly determined" in a prior criminal conviction. Id. at 569 (internal quotation marks and citations omitted); Pet. App. 4a. The court of appeals then held that collateral estoppel did not bar relitigation of any issue of law because the conviction for wire fraud did not require a determination of whether Zandford's "fraud was sufficiently connected to a securities transaction."[4] Pet. App. 5a.

The court of appeals also considered the SEC's arguments that collateral estoppel barred relitigation of the fact that "Zandford sold securities as part of a scheme to misappropriate proceeds," and that the district court properly found that such a scheme satisfies the "in connection with" requirement as a matter of law. Pet. App. 5a. The court of appeals accepted the SEC's contention that "the criminal trial established the fact that Zandford sold securities as part of a scheme to misappropriate proceeds."[5] Pet. App. 5a. It concluded, however, that "[t]he

[4] The court added that "[s]ince Zandford was never charged with a criminal violation of § 10(b), he did not have the opportunity to argue at trial or on appeal that, as a legal matter, his fraud was not sufficiently connected to a securities transaction." Pet. App. 5a.

[5] The court of appeals did not address Zandford's argument below that for purposes of collateral estoppel, the SEC did not establish any of the facts relating to securities that were discussed in the superseding indictment because they were not directly determined in the wire fraud case.

record contains no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion." Pet. App. 9a. The court of appeals also noted that the SEC did not dispute in its brief or at oral argument that this was a discretionary brokerage account and that Zandford "could trade securities without first having to gain the Woods' approval." Pet. App. 10a.

Within this context, the court of appeals held that the "only connection with federal securities laws is that the funds were converted from a securities investment account." Pet. App. 14a (internal quotation marks and citation omitted). The court of appeals also held that the "'intent to cause a conversion . . . at some uncertain future time and through uncertain means does not bring federal law into play, even though that intent is held at the time a purchase or sale of securities occurs.'" Pet. App. 10a (quoting Pross v. Katz, 784 F.2d 455, 459 (2d Cir. 1986)). Accordingly, the court of appeals concluded that the SEC was not entitled to summary judgment because it had not established, through the criminal trial papers it relied upon, that fraud was committed in connection with a securities transaction, even though the proceeds were converted to Zandford's use thereafter. Pet. App. 8a-14a. The court of appeals also directed that the case be dismissed on remand. Pet. App. 14a.

The SEC sought rehearing and rehearing en banc. It asked the court of appeals to reinstate the district court decision granting summary judgment to the SEC. Opp. App. 4a, 7a. The SEC neither questioned the court's order that the case be dismissed on remand nor asked the court to consider the adequacy of the civil complaint to state a cause of action. Opp. App. 4a, 7a. The court of appeals denied the petition for rehearing and rehearing en banc. Pet. App. 51a.

REASONS FOR DENYING THE PETITION

I. THE ISSUE PRESENTED FOR REVIEW WAS NEITHER PRESSED BY THE SEC BELOW NOR PASSED UPON BY THE COURT OF APPEALS.

The petition for certiorari asks this Court to grant review and to consider whether the order remanding the case with instructions to dismiss the action against Zandford was in error because the SEC's civil complaint states an actionable claim of securities fraud under § 10(b). Pet. 7, n.2. The SEC, however, did not question the order to dismiss the case when it sought rehearing. Opp. App. 4a, 7a. Further, the SEC never asked the court of appeals to consider, and the court of appeals never decided, the sufficiency of the complaint to state a cause of action. Rather, the court of appeals used the more limited set of facts stated in the superseding indictment to evaluate the securities fraud claim. Pet. App. 2a, 5a, 14a. Therefore, this Court should deny the petition because the SEC is asking this Court to decide an issue that was neither raised nor considered below. See, e.g., Taylor v. Freeland & Kronz, 503 U.S. 638, 646 (1992) ("[T]his Court does not decide questions not raised or resolved in the lower court[s].") (internal quotation marks and citation omitted); Delta Air Lines, Inc. v. August, 450 U.S. 346, 362 (1981) ("Although defendant's petition for certiorari presented the question of the District Judge's abuse of discretion in denying defendants costs under Rule 54(d), that question was not raised in the Court of Appeals and is not properly before us.").

In a short footnote, the SEC justifies this attempt to recast the case as follows:

> Because the court of appeals, rather than merely reversing the district court's grant of summary judgment, dismissed the Commission's complaint for failure to state a claim, this Court must assume that the allegations in the complaint are true and could affirm the dismissal only if the Commission could prove no set of facts that would entitle it to relief. See Hartford Fire Ins. Co. v. California, 509 U.S. 764, 811 (1993).

Pet. 7, n.2. The proffered justification is inadequate. The SEC's authority for this assumption, Hartford Fire, merely states the standard that applies when a court is considering a motion to dismiss a complaint. 509 U.S. at 811. That fundamental proposition is not relevant here because the court of appeals did not rule on a motion to dismiss the complaint. In fact, there is no indication in its opinion that the court of appeals ever reviewed the complaint.

Rather, the decision by the court of appeals to dismiss the case, in effect granting summary judgment to the non-moving party, is an unusual, but not unrecognized action by an appellate court.[6] See 10A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 2720 (3d ed. 1998) ("Wright & Miller") ("[I]f the facts were fully developed at the summary-judgment hearing so that the court of appeals can determine that the nonmoving party clearly was entitled to a judgment as a matter of law, an entry of judgment for

[6] The opinion does not explain the reason for dismissing the case, and the SEC did not raise the issue when it sought rehearing. The court of appeals may well have concluded that the SEC had fully developed the facts based upon something that was said at oral argument. It may also have reached that conclusion because the SEC claimed in its memorandum accompanying the motion for summary judgment that the facts described in the superseding indictment mirrored the facts stated in the complaint, suggesting that the SEC had no additional evidence it wished to present. Opp. App. 15a-16a ("The facts underlying Zandford's criminal case are identical to those alleged under the Commission's general factual allegations and, more specifically, the misappropriation allegations of the instant complaint."). Regardless, the SEC could have eliminated the confusion if it had brought the issue to the attention of the court of appeals.

the nonmoving party may be proper if there is no procedural prejudice to the moving party."); see, e.g., Dickeson v. Quarberg, 844 F.2d 1435, 1444 n.8 (10th Cir. 1988) (granting partial summary judgment to non-moving parties because "issue[s] were fully explored"); Procter & Gamble Indep. Union v. Procter & Gamble Mfg. Co, 312 F.2d 181, 190 (2d Cir. 1962) ("Since we hold that there was no triable issue of fact, and that defendant, although it made no cross motion, was entitled to summary judgment, summary judgment will be entered for defendant."), cert. denied 374 U.S. 830 (1963).

Thus, if the SEC considered the order dismissing the case outright to be procedurally prejudicial, it could have filed a petition for rehearing, asking the court of appeals to modify its order. The SEC did in fact seek rehearing and rehearing en banc, but did not ask the Court to reconsider the remand order. Opp. App. 4a (stating that "[t]he issue on which the Commission [sought] rehearing [was] whether the defendant's failure to tell his customer that he intended to convert the proceeds of each of the securities sales was 'in connection with' those sales"). Moreover, the SEC has neither asked this Court to consider the authority of the court of appeals to order summary judgment in favor of a non-moving party,[7] nor has it raised an objection to the procedural fairness of dismissing the action rather than remanding for further proceedings.[8] See

[7] The SEC should have raised this issue as a question presented for review. See Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp, 510 U.S. 27, 30-31 (1993) (dismissing certiorari as improvidently granted where petitioner failed to raise a threshold standing issue as a question presented for review, in addition to the question upon which certiorari was granted).

[8] This Court has had occasion to grant certiorari and reverse a court of appeals' decision to dismiss a case for reasons that had not been considered by the district court, where the ruling was procedurally unfair. See Fountain v. Filson, 336 U.S. 681, 682-83 (1949) (per curiam) (granting certiorari and reversing when the court of appeals, after deciding that summary judgment had been erroneously granted by the district court,

Helis v. Ward, 308 U.S. 365, 369-370 (1939) (refusing to consider the court of appeals' failure to remand for a new trial, where the issue was neither raised in a petition for rehearing in the court of appeals nor as a ground upon which the petition for certiorari was predicated).

II. THE PETITION'S RELIANCE ON FACTS NOT CONSIDERED BY THE COURT OF APPEALS MIRES THIS CASE IN FACTUAL ISSUES THAT ARE NOT WORTHY OF REVIEW BY THIS COURT.

The petition for certiorari ignores that the SEC could not rely on the allegations in the civil complaint, particularly those related to the mutual fund account, once it elected to pursue summary judgment on the basis of collateral estoppel. See 10A Wright & Miller § 2721 n.8 (citing cases holding that when considering a motion for summary judgment, the court cannot consider allegations contained in the pleadings, but rather must make its legal conclusions from facts shown to exist through the evidence submitted with the motion for summary judgment) (citations omitted). The SEC's motion for partial summary judgment and supporting memorandum of law state that because "the jury [in the wire fraud case had] already spoken regarding Zandford's liability," he was collaterally estopped from relitigating these claims and that the SEC was entitled to summary judgment on the civil fraud claims. Opp. App. 16a. Further, the SEC opposed Zandford's discovery request, claiming that such discovery was irrelevant to answer the motion for partial summary judgment because "[t]he Commission's motion for partial summary judgement [sic] is based exclusively on the application of the doctrine of collateral estoppel." Opp. App. 11a (emphasis added).

For purposes of summary judgment, the SEC substantially narrowed the factual basis for its case.[9] The primary evidence the SEC relied upon was the superseding indictment in the wire fraud case. The superseding indictment refers to only one investment account and contains general allegations of securities being sold or liquidated.[10] Pet. App. 41a-42a. The SEC did not, however, establish the identity of any securities that were sold. Therefore, the court of appeals, focusing on the only account before it, the brokerage account, noted that the SEC never contested that this was a discretionary account, which meant that Zandford could trade without consulting with his clients.[11] Pet App. 9a -10a. This factor was important to the decision of the court of appeals because it helped lead to the conclusion that the sales were conducted in a "routine and customary fashion."[12] Pet. App. 9a.

Although it could have sought certiorari and asked this Court to review the issue decided below, whether the facts that were established by the wire fraud conviction also established securities fraud, the SEC has not taken that position. Instead, it now attacks the reasoning of the

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exceeded its authority and ordered that summary judgment be entered on a different theory that had not been presented to the district court). That situation, however, is not presented here because the SEC has not raised it.

[9] The SEC recognized that the churning claim asserted in the complaint was not addressed in the criminal case and expressly noted that it was not moving for summary judgment on that claim. Opp. App. 16a, n.1.

[10] The jury charge, verdict form, criminal judgment, and opinion on appeal do not add significantly to the evidence established by the superseding indictment, and the petition does not rely on them in any material way.

[11] The petition for certiorari acknowledges that the Woods entrusted Zandford with $419, 255 to invest "in his discretion." Pet. 2.

[12] Because it was a discretionary account, Zandford had sole authority to make investment decisions. See, e.g., Bowley v. Stotler, 751 F.2d 641, 644 (3d Cir. 1985).

court of appeals on the basis of the facts asserted in the complaint.[13] The civil complaint contains several allegations regarding a mutual fund account that are not mentioned in the summary judgment papers or in the opinions below. The complaint states that Zandford misappropriated $343,000 from both the investment account and a mutual fund account. Pet. App. 27a at ¶ 10. It also alleges that between May and June of 1988, Zandford issued three checks to himself totaling $41,000, which were allegedly drawn on the Woods' mutual fund account from funds obtained through the sale of mutual fund shares, Pet. App. 28a at ¶ 16. The complaint further alleges that between July of 1989 and June of 1990, Zandford obtained approximately $111,000 by liquidating shares in the mutual fund account on ten occasions.[14] Pet. App. 29a at ¶ 18.

These allegations present details of a fraudulent scheme relating to a mutual fund account that were never analyzed by the court of appeals, but are incorporated in the petition for certiorari and relied upon by the SEC to establish why this case is worthy of review. The difference is critical because the court of appeals rested its decision in part on the SEC's failure to dispute

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[13] See, e.g., Pet. 3-4 (stating that the complaint alleged that Zandford "without the Woods' knowledge or consent . . . issued checks to himself drawn on the Woods' joint mutual fund account, and that the funds to pay the checks were obtained through the sale of mutual fund shares," that Zandford "sold mutual fund shares or other securities owned by the Woods without their knowledge or consent and misappropriated the proceeds," and that Zandford "thereby violated section 10(b) and Rule 10b-5") (citing Pet. App. 28a-31a); Pet. 7-8, 9, 16 (additional references to mutual fund shares).

[14] Similarly, the complaint references specific stock transactions, specific dollar amounts, and specific actions Zandford took with the money, but these specifics are not found in the superseding indictment. The complaint alleges that Zandford sold three securities in the Wood/Okstulski investment account for a total of $145,000 and that Zandford obtained a check in the amount of the proceeds, which he deposited in a bank account under his control. Pet. App. 29a at ¶ 17. The complaint also alleges that Zandford sold $46,000 worth of securities in the investment account and then caused checks in that amount to be issued to Woods/Okstulski, which he then deposited in accounts in his name or under his control. Pet. App. 29a at ¶ 18.

Zandford's claim that the brokerage account was a discretionary account and that the bare reference to sales of securities did not establish fraud because he was authorized to trade securities without obtaining prior approval. Pet. App. 9a-10a. The petition, by including the mutual fund account in its analysis, never directly confronts the fact that the decision of the court of appeals is limited to a discretionary brokerage account.

It is impossible at this point to determine how this case would have been litigated or decided below if anything other than the discretionary brokerage account were in issue. By injecting the mutual fund account into the analysis at this point, the SEC has mired this case in factual issues that are not worthy of this Court's consideration, even if the case might otherwise present securities fraud issues that would be worthy of review.

III. THIS CASE IS NOT WORTHY OF REVIEW BECAUSE THRESHOLD ISSUES REGARDING COLLATERAL ESTOPPEL MAY PREVENT THIS COURT FROM REACHING ANY QUESTION REGARDING THE PROPER APPLICATION OF § 10(b) AND RULE 10b-5 WHEN A BROKER CONVERTS A CLIENT'S ASSETS.

Even if this Court determines that the issues presented are worthy of review, this case is not a suitable vehicle to consider the proper application of § 10(b) and Rule 10b-5. As a threshold matter, this Court would need to determine which of at least three different sets of facts should be considered to decide the case. Sorting through this collateral estoppel thicket that the SEC has created is not an appropriate use of this Court's limited resources. The SEC in the petition for certiorari claims that the entire record, including the complaint, should be considered. Pet. 7 n.2. The court of appeals, however, limited its review for purposes of summary judgment

to the facts contained in the superseding indictment. Pet. App. 2a, 5a.

A third alternative, which Zandford raised below and resubmits here, would limit even further the facts that were established for purposes of summary judgment. While Zandford is estopped from contesting those issues of fact and law that were necessarily decided by the jury's verdict, that does not mean that all facts alleged in the superceding indictment should be treated as established facts. See Emich, 340 U.S. at 569 ("In the case of a criminal conviction based on a jury verdict of guilty, issues which were essential to the verdict must be regarded as having been determined by the judgment."). The issue of whether Zandford liquidated securities was not "actually determined" by the jury's verdict because securities sales were not a necessary element of any of the criminal counts of the superseding indictment. Ashe v. Swenson, 397 U.S. 436, 442 (1970) (stating that collateral estoppel "bars relitigation between the same parties of issues actually determined at a previous trial"). The court of appeals affirmed the criminal wire fraud conviction against an insufficiency of evidence claim, without even referring to securities. Pet. App. 35a-38a. Rather, in pertinent part, it described the essential evidence: 1) Zandford had systematically transferred large sums of money from the Woods' account to his own accounts over a nineteen month period; 2) prior to November 1987, the Woods had no relationship with Zandford; and 3) Zandford, and not the Woods, benefitted from the money transfers. Pet. App. 36a. If the Court were to take this case and to determine that Zandford's view is correct, it could not reach the question presented for review because there is no evidence of any securities transactions in the summary judgment record.

IV. THE DECISION OF THE COURT OF APPEALS IS NOT IN CONFLICT WITH ANY DECISION OF THIS COURT.

The SEC portrays the ruling below as a significant departure from this Court's decisions in this area of securities law. Its principle contention is that the ruling cannot be reconciled with United States v. O'Hagan, 521 U.S. 642 (1997), and Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971). The court of appeals, however, fully considered and correctly applied these decisions to the facts before it.[15]

A. United States v. O'Hagan, 521 U.S. 642 (1997).

In O'Hagan, this Court concluded that the undisclosed use of misappropriated insider information to purchase a security constituted securities fraud because the misappropriation of insider information is almost always exploited through securities trading. 521 U.S. at 655-56 (holding that the "in connection with" element was met because "fraud is consummated . . . when, without disclosure to his principal, he uses the information to purchase or sell securities").

Here, the court of appeals found that the SEC did not show this type of critical link. Given the record the SEC placed before it, the court of appeals properly concluded that "[i]t is the SEC's burden to identify a fraudulent act and a particular sale of securities that would satisfy the in connection with requirement. This it has failed to do."[16] Pet. App. 9a. The fraud here

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[15] For purposes of this analysis, Zandford confines the discussion to the facts established in the superseding indictment because those are the facts upon which the court of appeals based its decision.

[16] A case the SEC cites in this context, SEC v. Jakubowski, 150 F.3d 675 (7th Cir. 1998) (Easterbrook, J.), cert. denied, 525 U.S. 1103 (1999), actually supports the court of

was consummated when the money was converted, not when a security was bought or sold.[17] Pet. App. 9a-10a ("Zandford's fraud lay in absconding with the proceeds .... The record contains no suggestion that the sales themselves were conducted in other than a routine and customary fashion.").

The SEC attempts to, but cannot compensate for its failure to properly prove its case, by wrenching O'Hagan from the context in which it was decided and applying it here.[18] O'Hagan does not create an all-purpose ongoing duty to disclose such that any securities transaction occurring between the time the account was set up and when its assets were converted is a § 10(b) violation.[19] Pet. App. 6a. ("The federal securities laws do not cover all types of

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appeals' decision here. The petition cites Jakubowski correctly for its observation that the fraud need not be about the value of a security. Pet. 11. The Seventh Circuit in Jakubowski also noted approvingly that many of its cases "say that a misrepresentation can be 'in connection with' the purchase or sale of securities only if it influences an investment decision." 150 F.3d at 680. There is no securities investment decision in this case that was influenced by fraud, and that is what led the court of appeals to rule as it did.

[17] It is in this context that the court of appeals here expressed concern that the SEC's position, if accepted, would result in § 10(b) subsuming "significant areas of state law." Pet. App. 14a. The court of appeals' references to state law are not inconsistent with any language in O'Hagan, as the petition argues. Pet. 12-13.

[18] In O'Hagan, the SEC limited the sweep of its "in connection with" argument, emphasizing that the misappropriated information could "only" be used in a securities transaction. 521 U.S. at 657-58; Id. at 683-84 (Thomas, J., concurring). In this case, the SEC does not limit the implications of its position. If the SEC's position were accepted, any securities transaction occurring during the course of a fraudulent scheme would constitute securities fraud.

[19] Using non-disclosure of a breach of fiduciary duty as itself being an independent breach of fiduciary duty has been rejected in other contexts. See Kas v. Financial Gen. Bankshares, Inc., 796 F.2d 508, 513 (D.C. Cir. 1986) ("[P]laintiff may not 'bootstrap' a claim of breach of fiduciary duty into a federal securities claim by alleging that directors failed to disclose that breach of fiduciary duty."); Panter v. Marshall Field & Co., 646

fraud.").

B. Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971).

The SEC erroneously argues that the "decision of the court of appeals conflicts with this Court's decision in Bankers Life." Pet. 13. In Bankers Life, this Court rejected the holding of the Second Circuit court of appeals that the securities fraud laws should be "limited to preserving the integrity of the securities markets." 404 U.S. at 12 (citation omitted). Based on this erroneous view of the law, the court of appeals had decided that there was no fraud "in connection with" a securities transaction, although the corporate seller was induced to sell a security on the mistaken belief that it would receive the proceeds from the sale because the purchaser was not a party to the fraud. 430 F.2d 355, 360 (2d Cir. 1970). This Court, however, made clear that the facts established securities fraud because the sale was induced by fraud and it made no difference that the purchaser was not implicated and the integrity of the market was not affected when the proceeds were misappropriated. 404 U.S. at 10-12. The Court held that § 10(b) "must be read flexibly, not technically and restrictively." Id. at 12.

Unlike the situation presented in Bankers Life, here the SEC did not show that the Woods were fraudulently induced to sell any security. Rather, the evidence established that they were fraudulently induced to place their money in an account that was subsequently looted. Pet. App. 9a-10a. The court of appeals here correctly concluded that Zandford's fraudulent activities were

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F.2d 271, 288 (7th Cir. 1981) (holding that the "disclosure philosophy of the statute [does not obligate] defendants to reveal either their culpability of their activities, or their impure motives for entering the allegedly improper transaction"), cert. denied, 454 U.S. 1092 (1982).

not sufficiently connected to a securities transaction where the evidence established by the SEC based on its collateral estoppel theory only established that funds were converted from a securities account and the actual role of securities in the fraud is not established. Pet App. 8a-14a. There is no conflict with Bankers Life.

V. THERE ARE NO CONFLICTS WITH OTHER COURTS OF APPEALS.

There is no conflict with the 1982 Ninth Circuit decision United States v. Kendrick, 692 F.2d 1262 (1982), cert. denied, 461 U.S. 914 (1983), despite the SEC's claims in the petition. Pet. 15-16. Kendrick is readily distinguishable because it involved securities in non-discretionary margin accounts that a broker used as collateral for loans he obtained on the accounts. 692 F.2d at 1265-66. Here, the court of appeals was careful to note that the SEC never disputed the fact that the brokerage account was discretionary. Pet. App. 10a. Further, the Kendrick court expressly found that the fraud was linked to sales of securities. The court found that the collateral interest in the securities that the fraudulently obtained loans created were sales of interests in those securities. 692 F.2d at 1265. The court rejected an argument that the fraud was not "in connection with" the loans. Id. ("At the time Kendrick caused Dean Witter to issue the checks . . . he was engaged in fraud."). Unlike the situation posed in Kendrick, the court of appeals in this case looked for, but could not find, evidence of a direct link between a securities transaction and fraud because the SEC failed to present it. Pet App. 9a.-10a

Finally, even if there were a circuit split, it would not warrant review by this Court because this is a rarely litigated issue. Zandford can find no case published in the twenty years

since Kendrick was decided, in the Ninth Circuit or elsewhere, that uses Kendrick for the proposition put forth in the petition for certiorari.[20] Moreover, it is particularly telling that the SEC did not as much as cite Kendrick either in its brief in the court of appeals or in its petition for rehearing. Before the court of appeals, the SEC cited a single district court case, Henricksen v. Henricksen, 486 F. Supp. 622, 629 (E.D. Wis. 1980), Pet. App. 11a, as the only case directly on point, and never mentioned this twenty-year old decision of a sister court of appeals.

The other cases the petition relies on as inconsistent with the decision of the court of appeals here, but apparently not rising to conflict status, are Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979), and Allico Nat'l Corp. v. Amalgamated Meat Cutters, 397 F.2d 727 (7th Cir. 1968). Pet 16-17. Both of these cases are readily distinguishable from this case because they deal with conversions of specific bonds or stock that were wrongfully withheld from the lawful owner. See Mansbach, 598 F.2d at 1027 (finding a § 10(b) and Rule 10b-5 violation where a brokerage firm refused to return certain bonds, which had been pledged to it as collateral); Allico, 397 F.2d at 727 (finding a violation of federal securities laws involving a union's wrongful misappropriation of 25,000 shares of stock).

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[20] Zandford has found only one unpublished decision, United States v. Walls, 949 F.2d 400, No. 90-50412, 1991 WL 261632, at *2 (9th Cir. 1991), which cites Kendrick on this point. The Ninth Circuit found that Walls' use of his client's assets in five separate stock transactions without his client's knowledge constituted a violation of Rule 10b-5. Id. at *1. Walls cited Kendrick and incorrectly described it as a case where the broker had used client funds to purchase securities for his personal benefit. Id. at *2. Although it then quoted Kendrick for the proposition that the broker failed to disclose that he was acting beyond his authority in using customer funds, the court also found that the government had established that Walls was engaging in fraud when he engaged in numerous specific transactions involving securities. Id.

VI. THE DECISION IN THIS CASE IS NOT SUFFICIENTLY IMPORTANT TO WARRANT REVIEW BY THIS COURT.

This case does not pose an issue of national concern. To the extent that broker theft is a national problem, it is fully addressed by federal and state law and is not hampered by the decision of the court of appeals here. The SEC was only able to produce one 1981 district court case that it claimed presented a similar situation in which a broker sold securities and misappropriated the proceeds. Pet. App. 11a ("The SEC has advanced but one case in which a court has held that a broker who sells securities and misappropriates the proceeds has violated the federal securities laws, and that decision provides no analysis to support the holding.") (citing Henricksen, 486 F. Supp. at 629). Although the SEC claims that it has enforced the securities laws in its own proceedings on this basis for over 50 years, there are a limited number of reported actions over that 50 year period and none of the cases to which the SEC cites deal with discretionary accounts. Pet. 17 & n.6. Further, the petition cites to no reported cases where private litigants rely on this type of fraud when proceeding under § 10(b) or Rule 10b-5.

While the SEC plays a significant role in regulating the securities industry, it does not act alone. See Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 171 (1994) ("The [securities acts] create an extensive scheme of civil liability. The [SEC] may bring administrative actions and injunctive proceedings to enforce a variety of statutory provisions. Private plaintiffs may sue under express private rights of action contained in the Acts.") (emphasis added). Federal and state civil and criminal laws cover this type of theft and provide the government and private litigants with redress, without resort to the securities fraud laws. Further, through enforcement of its rules and regulations, self regulation by the National Association of

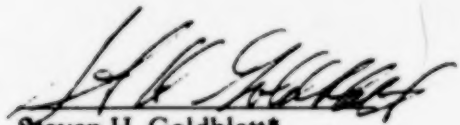
Securities Dealers ("NASD"), is also a significant means of policing the brokerage industry and remedying improper activity. See United States v. NASD, 422 U.S. 694, 710 n.19 (1975) (stating that "the industry . . . is afforded the initial opportunity to police its own practices"); Jones v. SEC, 115 F.3d 1173, 1178-82 (4th Cir. 1997) (generally discussing the overlapping and broad authority of the NASD and the SEC to enforce securities laws, including the NASD's ability to hold hearings to determine whether a member has defrauded a client, and subsequent ability to suspend a broker from trading or to cancel a broker's membership), cert. denied 523 U.S. 1072 (1998).

Finally, the SEC errs in its claim that a broad reading of the decision of the court of appeals would exempt "[d]eceptive conduct by brokers . . . includ[ing] churning customer accounts" from SEC regulation under § 10(b) and Rule 10b-5. Pet. 19. First, even the SEC acknowledged in the district court that the churning claims asserted in the complaint would not be proven by the criminal conviction. Opp. App. 16a n.1. Second, churning would easily meet the concern of the court of appeals that fraud be connected to a particular security or securities transaction because the repeated sales of securities to generate fees is precisely the type of fraud that is directly related to securities transactions. Pet. App. 9a-10a.

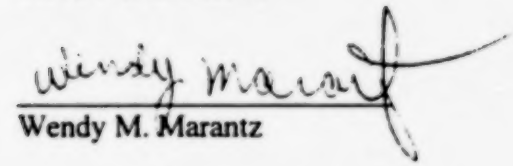
CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,



Steven H. Goldblatt*



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